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No. 07-512

IN THE
Supreme Court of the United States

PACIFIC BELL TELEPHONE COMPANY
d/b/a AT&T CALIFORNIA, *et al.*,

Petitioners,

v.

LINKLINE COMMUNICATIONS, INC., *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR RESPONDENTS

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CORPORATE DISCLOSURE STATEMENT

Respondent linkLine Communications, Inc., has no corporate parent and no publicly held corporation owns more than 10% of its stock.

Respondent Nitelog, Inc., has no corporate parent and no publicly held corporation owns more than 10% of its stock.

Respondent In-Reach Internet, LLC (now known as InReach Internet, Inc.) has a corporate parent named MobilePro Corp., a publicly held corporation; and In-Reach Internet, LLC, has assigned to its former corporate parent Balco Holdings, Inc., a California corporation, its rights with respect to this litigation subject to retention by MobilePro Corp. of consent and rights to receive a portion of any proceeds from this litigation as set forth in that assignment agreement dated as of October 31, 2005, by and among In-Reach Internet, LLC, InReach Internet, Inc., Balco Holdings Inc; and no publicly held corporation owns more than 10% of the stock of Balco Holdings, Inc., but MobilePro Corp. is a publicly held corporation that owns, and is the corporate parent of, InReach Internet, Inc., the successor of the original named Plaintiff In-Reach Internet, LLC.

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STATEMENT OF THE CASE

A. Background

Respondents (plaintiffs below) are four Internet Service Providers (ISPs). Pet. App. 2a-3a. They provide Internet access, including via Digital Subscriber Line ("DSL") service, and related services to retail customers, in competition with petitioners. *Id.* Unlike facilities-based local telephone companies (such as petitioners), respondents do not own or control the transmission lines to connect their customers to the Internet. *Id.* Instead, they require access to petitioners' local phone facilities, including local telephone lines, for such connections, which respondents leased from petitioners on a wholesale basis under "a DSL transport" service. *Id.*

Petitioners (SBC entities, now AT&T) were organized so that they sold wholesale DSL access to independent ISPs and sold retail DSL Internet access through their retail affiliate to individual consumers. *Id.* at 3a. Petitioners supplied respondents at wholesale the necessary input (DSL transport) to their DSL service; and petitioners in turn competed with respondents in providing a retail bundled DSL Internet access service (incorporating DSL transport service, along with equipment, activation and online services). *Id.* at 2a-3a; *see also* J.A. 17 (¶ 19). Petitioners were required by federal telecommunications law to offer respondents their DSL transport service on a nondiscriminatory basis. Pet. App. 5a n.6.

B. District Court Proceedings

1. Initial Complaint and 2004 Order

In July 2003, respondents filed their complaint against petitioners, alleging they monopolized and attempted to monopolize the relevant regional DSL Internet service market in violation of Section 2 of the Sherman Act (15 U.S.C. § 2). Pet. App. 4a; J.A. 18-20 (¶¶ 22-24).[1] Respondents' complaint alleged that, "to exclude and unreasonably impede competition from independent ISPs," petitioners "created a price squeeze by charging ISP[s] a high wholesale price in relation to the price at which [petitioners] were providing retail services." J.A. 18 (¶ 23).[2] Petitioners' retail affiliate,

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1. Respondents alleged the market for DSL Internet service in petitioners' telecommunication service region in California is a relevant market. J.A. 13 (¶ 11). DSL is distinguishable from other means of connecting to the Internet because it is (a) faster, (b) "always on," (c) more reliable, and (d) allows many users in the same geographic area simultaneous access without affecting the speed or quality of the transmission. *Id.* DSL service is also distinguishable in that it can be made available over existing telephone lines which today connect virtually all businesses and households in California. *Id.* There is a discrete and separate market for DSL because of its distinct characteristics, pricing points and separate and distinct customers. *Id.*

2. Respondents also alleged petitioners adopted an array of anticompetitive procedures and practices that, taken in conjunction with price squeezing, were "calculated to deny ISPs access to an essential facility and to preserve and maintain [petitioners'] monopoly control of DSL access to the Internet." J.A. 19 (¶ 23(b)-(f)).

which provides a bundled offering of DSL access with both online Internet services and equipment (e.g., free modem), has taken in excess of 80% of the retail DSL market. J.A. 17 (¶ 19).

After this Court's decision in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004), petitioners moved for judgment on the pleadings under Fed. R. Civ. P. 12(c) contending that decision compelled judgment in their favor on respondents' complaint. Petitioners asserted they had provided DSL transport service to rival providers of retail Internet access service only under regulatory (FCC) compulsion; that they had no antitrust (as opposed to regulatory) duty to deal; and that respondents' allegations about the terms of compulsory dealings between petitioners and respondents failed to state a claim under Section 2, in light of *Trinko*. Pet. App. 65a-90; *see* J.A. 1 (No. CV 03-5265, No. 16, Notice of Motion and Motion for Judgment on the Pleadings)).

In the October 2004 Order ("2004 Order"), the district court granted petitioners' motion with respect to respondents' non-price squeeze allegations, concluding they were "refusal to deal" and "denial of access to essential facilities" claims barred by *Trinko*. Pet. App. 77a-86a, 90a-91a. But the court denied the motion as to the price squeeze claim, holding that "because a price-squeeze claim is actionable under existing antitrust standards, and because the Ninth Circuit has upheld the viability of price-squeeze claims in the context of highly regulated industries, *Trinko* does not bar [respondents'] price-squeezing claim." *Id.* at 91a; *see id.* at 90a ("And here, unlike the plaintiff's

refusal-to-deal claim in *Trinko*, [respondents'] price-squeezing claim falls within the range of recognized Section 2 claims.").

The court stated "*Trinko* simply does not involve price-squeeze claims" and petitioners' argument that "a price-squeeze claim is essentially a refusal-to-deal claim" – i.e., "claim that Firm One is refusing to deal with Firm Two on Firm Two's price terms" – "does not hold up to sustained scrutiny." *Id.* at 86a-87a. "Moreover, to the extent that price-squeeze claims are subject to the requirements set forth in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), then the transmutability of refusal-to-deal claims is limited still more." *Id.* at 87a.

The district court did not reach petitioners' "objections to the legal sufficiency of [respondents'] price-squeeze claims which [did] not derive from *Trinko*," and ordered respondents "to file with the Court an amended complaint limited to the price-squeeze claim that details beyond the normal requirements of [Fed. R. Civ. P.] 8 specific facts supporting [respondents'] price-squeeze claim." *Id.* at 91a.

2. Amended Complaint and 2005 Order

Respondents filed an amended complaint on their price squeeze claim, alleging that petitioners engaged in an unlawful price squeeze by "intentionally charging independent ISPs wholesale prices that were too high in relation to prices at which defendants were providing retail DSL services and necessary equipment to end-

user customers" and that "for a period by charging wholesale DSL prices to competing ISPs (such as [respondents]) that actually exceeded the prices at which [petitioners'] retail affiliate (PBI) was charging retail end-user customers for DSL [Internet] services and necessary equipment." J.A. 35 (¶ 25(A)(1)). This price squeezing made "it impossible for independent ISPs . . . to compete at the low retail prices set by [petitioners] for combined DSL-Internet Service and necessary equipment." *Id.*

Respondents further alleged that "if [petitioners] themselves charged their retail affiliate[] the same wholesale costs for DSL transport that they charged their wholesale ISP customers," the retail affiliate "could not cover [its] wholesale costs and make a profit from DSL service at [its] low retail prices for [the] bundled offering of DSL, Internet Service and necessary equipment (e.g., free modem and installation)." J.A. 36 (¶ 25(A)(3)). Moreover, "[g]iven the price margin relationship between retail and wholesale prices, [petitioners] are clearly attempting to compensate for deliberately sacrificing profits on the retail end of their operations (with offsetting margins on the wholesale side) in order to stifle, impede and exclude competition from independent ISPs. . . ." *Id.* Respondents alleged that petitioners' retail affiliate "has taken in excess of 80% of the [retail] DSL market" (J.A. 33 (¶ 20); and "competition in the provision of Internet service has been effectively eliminated in [petitioners'] California service areas, and consumers have been deprived of lower prices, a choice of service providers, greater efficiency and enhanced products" (J.A. 38 (¶ 26(b)).

Petitioners moved to dismiss the price squeeze claim of the amended complaint, arguing (a) price squeeze claims must satisfy the two prerequisites of a predatory pricing under *Brooke Group* – that is, predatory pricing of the retail Internet access service and recoupment – and (b) that the amended complaint failed to do so. Pet. App. 36a. In the April 2005 Order ("2005 Order"), the district court denied that motion. *Id.* at 25a-57a. The court stated that it was "inclined to apply the *Brooke Group* requirements to [respondents'] price squeeze claim," "find[ing] the policy arguments in favor of their application persuasive," but it "[n]evertheless . . . conclude[d] that it need not and should not resolve this difficult issue at this time" noting that "[t]he issue will thus be revisited at summary judgment." *Id.* at 47a-48a & n.15. The court gave two reasons for this. "First, the Court would benefit from further briefing and a fully developed factual record. Second, the Court finds that, even if the *Brooke Group* requirements were applied, the [amended complaint] would satisfy those requirements." *Id.* at 48a.

Then, examining the amended complaint's price squeeze allegations under the *Brooke Group* requirements, the court concluded respondents "can clearly prove a set of facts in support of their price squeeze claim that would entitle them to relief," noting that those allegations "contain[] price squeeze allegations substantially similar to those approved by the [Eleventh Circuit] in [*Covad Communications Co. v. BellSouth Corp.*, 374 F.3d 1044 (11th Cir. 2004)]." Pet. App. 48a-49a & n.16; *see id.* at 50a-52a. As the Eleventh Circuit had done in *BellSouth*, the district court addressed the sufficiency of the pleadings on the *Brooke*

Group elements under the "no set of facts" standard (*Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)) that was subsequently repudiated in *Bell Atlantic Corp. v. Twombly*, 127 S. Ct. 1955, 1969 (2007). The court determined that the amended complaint, "generously construed, would state a valid price squeeze claim under *Brooke Group*" and therefore denied the motion to dismiss. Pet. App. 56a.

In its 2005 Order, the district court also granted petitioners' alternative request to amend its earlier 2004 Order regarding *Trinko's* application to certify it for interlocutory appeal pursuant to 28 U.S.C. § 1292(b), identifying the "controlling question of law" as "whether *Trinko* bars price squeeze claims where the parties are compelled to deal under the federal communications laws." *Id.* at 56a-57a.[3] The Ninth Circuit granted interlocutory review. *Id.* at 92a.

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3. The court noted:

> [i]n light of [its] holding that the [amended complaint] can be read to state a viable price squeeze claim under *Brooke Group*, the issue before the Ninth Circuit will not only be whether *Trinko* bars price squeeze claims generally but, more specifically, whether it bars predatory price squeeze claims (i.e., price squeeze claims which comply with the *Brooke Group* requirements).

Id. at 56a n.22.

C. Ninth Circuit Proceedings and Opinion

A divided Ninth Circuit panel affirmed, ruling:

> Based on the record before us at this time, we are able to conclude that the district court was correct to deny the [petitioners'] motion for judgment on the pleadings because [respondent's] allegation that the pricing scheme created an anticompetitive price squeeze states a potentially valid claim under § 2 of the Sherman Act.

Pet. App. 18a-19a. The district court's ruling on the petitioners' "motion for judgment on the pleadings" was in the 2004 Order, which addressed the initial complaint and viability of price squeeze claims under *Trinko* (*Id*. at 53a, 56a-57a), not in the 2005 Order, which addressed the sufficiency of the amended complaint's allegations under *Brooke Group* (*id.* at 36a-52a).

The panel majority decision sets forth the allegations of both the complaint and amended complaint and discusses both the 2004 Order and 2005 Order (*id.* at 5a-8a), and states "[i]t is unclear at this juncture the extent to which [respondents] [are] basing [their] § 2 price squeezing theory on wholesale pricing, retail pricing, or both" (*id.* at 18a). Nevertheless, as the Government has stated in its briefs at the petition stage (U.S. Invitation Brief at 19 n.7) and here (U.S. Merits Brief at 8 n.5): "In the end, . . . [the court of appeals] affirmed the district court's denial of petitioners' 'motion for judgment on the pleadings,' [Pet. App.] at 19a, which was the ruling in the 2004 Order, not the 2005 Order."

In any event, the panel majority did not address the sufficiency of respondents' allegations under *Brooke Group*, or whether respondents' price squeeze claims would need to meet the pleading requirements for a predatory pricing claim under *Brooke Group*. This was apparently because the majority did not believe that these *Brooke Group* issues, addressed in the 2005 Order, were properly before it on the interlocutory appeal. As the Government has stated in its brief on petition and here, "it is unclear whether the 2005 Order and the amended complaint are properly at issue in this interlocutory appeal." U.S. Invitation Brief at 20; U.S. Merits Brief at 17.

Petitioners had argued to the court of appeals that "even if *Trinko* did not bar their price squeeze claim, the Court should not reach the *Brooke Group* issue because that issue is not properly before the Court." 05-56023, Docket No. 25, Appellant's Reply Brief at 18 (2/21/06).[4] Petitioners offered three reasons:

> First, as [respondents] acknowledge, although the issue was addressed in the district court's April 2005 order, the district court did not resolve it. It concluded that it need not do so because [respondents] argued (and the

4. Petitioners' argument was responding to respondents' argument that the court of appeals could and should decide whether *Brooke Group* elements were required to state a valid price squeeze claim that would survive *Trinko*, and if they were required, that respondents' amended complaint had sufficiently pled those requirements as the district court had ruled in its 2005 Order. 05-56023, Docket No. 21, Brief of Appellees at 24, 28-31 (1/18/06).

> district court agreed) that, even if *Brooke Group* applies, their [amended] complaint meets its pleading standards [and] . . . also concluded that it would benefit from a more fully developed factual record before finally resolving the issue.

Id. Second, petitioners noted, "the issue was not part of the order the district court certified for interlocutory appeal. The only order certified was the district court's October 2004 order, which was limited to the application of *Trinko* and did not address the *Brooke Group* issue." *Id.* "And, third, [respondents] did not file any cross-petition to bring either the April 2005 order or this issue before this Court." [5] *Id.*

The panel majority seems to have endorsed petitioners' view of what was before it, because it affirmed only on the narrow issue framed by the district court's denial of the "motion for judgment on the pleadings" in the 2004 Order, and not the 2005 Order denying motion to dismiss the amended complaint under *Brooke Group*. Pet. App. 19a. The panel majority decision states "[i]t is unclear at this juncture the extent to which [respondents] [are] basing [their] § 2 price squeezing theory on wholesale pricing, retail pricing,

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5. Petitioners' Opening Brief before the court of appeals noted: "The district court's [2005] [O]rder also addressed whether a price squeeze claim, if it were to survive *Trinko*, would need to meet the pleading requirements for a predatory pricing claim under *Brooke Group*. . . ." but the court "need not address that issue, however, as the price squeeze claim does not survive *Trinko*." 05-56023, Docket No. 14, Appellants' Opening Brief at 12 n.7 (12/5/05).

or both." *Id.* at 18a. "However, since [respondents] could prove facts, consistent with its complaint, that involve only unregulated behavior at the retail level, [their] action or lawsuit survives a motion for judgment on the pleadings." *Id.*[6]

Judge Gould apparently had a different view of what was certified for review – if not necessarily on substantive antitrust law and the implications of *Brooke Group*.[7] In his dissent, Judge Gould concluded that the amended

6. The panel majority stated:

> We do not preclude the district court, however, from re-examining the viability of this claim on summary judgment after the record is more fully developed and it is clear whether the complained of behavior took place at the regulated wholesale level, the unregulated retail level, or some combination of the two, and to what extent, if any, the responsible agencies have devoted attention to or had involvement in the complained of conduct.

Pet. App. 18a.

7. Days before its decision here, the Ninth Circuit recognized:

> the Court's opinions [in *Brooke Group* and *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, 549 U.S. 312 (2007)] strongly suggest that, in the normal case, above-cost pricing will not be considered exclusionary conduct for antitrust purposes, and the Court's reasoning poses a strong caution against condemning bundled discounts that result in prices above a relevant measure of costs.

Cascade Health Solutions v. PeaceHealth, 502 F.3d 895, 912 (9th Cir. Sept. 4, 2007), *amended on other grounds*, 515 F.3d 883, 901 (9th Cir. 2008).

complaint should be dismissed. *Id.* at 19a-24a. Though his dissent does not discuss the 2005 Order's rulings on *Brooke Group*, Judge Gould concluded respondents could not state an antitrust violation for price squeeze without satisfying the predatory pricing requirements of *Brooke Group* with respect to petitioners' pricing in the retail DSL service market, finding the amended complaint deficient in that regard. *Id.* at 22a-23a. He stated "[petitioner's] setting of its sale price of the use of its land lines by ISPs in a wholesale transaction cannot be the basis of an antitrust claim in light of *Trinko*." *Id.* at 22a. "That, however, does not dispose of scrutiny of [petitioner's] conduct in the retail market, for it is the price at which [petitioner] sells DSL service to its retail customers that squeezes [respondents'] ability to resell internet connections at a profit." *Id.* Therefore, "the 'price squeeze' contention boils down to a claim of a predatory pricing on sales of internet connections by [petitioners] in the retail market." *Id.* Judge Gould stated,

> if [respondents] are able to allege that the [petitioners] had market power in the retail market to set or influence the price, and that their retail sales of internet connection were predatory in the sense of being below cost with a real prospect of recoupment, then the case should proceed for factual development.

Id. at 20a-21a.

Judge Gould concluded that the amended complaint did not sufficiently plead the requirements of a Section 2 monopolization claim based on predatory pricing under

Brooke Group. *Id.* at 23a. But he also concluded "it would [not] be correct to dismiss the complaint on the pleadings with prejudice" because "we have not heretofore held that there must be a showing of market power in the retail market, nor held that the standards of *Brooke Group* must be applied in assessing predation in the retail side of a 'price squeeze.'" *Id.* Instead, he recommended, "after dismissal, [respondents] should have been free to amend their complaint if they could assert in good faith the allegations that are requisite here, after *Trinko*." *Id.* at 23a-24a.

Respondents now believe that is a proper disposition of this matter and request that this judgment below be vacated and the case remanded for further proceedings.

SUMMARY OF ARGUMENT

I. Although it is unclear whether the 2005 Order and the amended complaint are properly at issue in this interlocutory appeal, it is clear respondents' pricing squeeze claim survives *Trinko* only if it satisfies the requirements of a predatory retail pricing claim under *Brooke Group.* Judge Gould's dissent and the decisions of the only two other circuit courts (the Eleventh Circuit and D.C. Circuit) having addressed the issue recognize that predatory price squeeze claims satisfying the requirements of *Brooke Group* are viable under "'established antitrust standards'" and therefore are not barred by *Trinko.* Petitioners point to no authority or rationale for imposing a *Trinko* bar to a valid *Brooke Group* predatory retail pricing claim along the lines set out in Judge Gould's dissent.

A. Petitioners and their supporting *amici curiae*, notably the Government, argue the panel majority decision erred in recognizing respondents' price squeeze allegations survive *Trinko*, absent an antitrust duty to deal or predatory pricing under *Brooke Group.* U.S. Merits Brief at 9, 29; U.S. Invitation Brief at 13-14, 20-21; Pet. 21-22.[8] Petitioners neither definitively admit nor deny that a *Brooke Group* claim along the lines suggested by Judge Gould's dissent (i.e., predatory pricing at the retail level) survives *Trinko.*[9] In any event, their own cited authority, including Judge Gould's dissent, clearly establish that *Trinko* does not bar a predatory pricing claim under *Brooke Group.* There is no contrary authority suggesting that such a claim would be barred absent an antitrust duty to deal (where dealings are compelled by regulation); and it would be irrational to read *Trinko* as barring a *Brooke Group* claim challenging unregulated retail pricing conduct.

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8. The Government, however, questioned the Court's jurisdiction to decide whether "respondents could avoid dismissal by alleging the elements of a predatory-pricing claim under *Brooke Group*." U.S. Invitation Brief at 20 n.8.

9. *See* Brief of *Amici Curiae* Professors and Scholars in Law and Economics in Support of the Petitioners at 2 ("We agree with Judge Gould's dissent . . . that *Trinko* 'takes the issues of wholesale pricing out of the case,' such that the [respondents'] only possible remaining theory of harm would be predatory pricing at the retail level – which the [respondents] did not allege." (citation omitted)); *see also* Brief for Verizon Communications Inc. and The National Association of Manufacturers as *Amici Curiae* Supporting Petitioners at 22 ("[petitioners'] low retail price is lawful as long as it is not predatory under the demanding standards of *Brooke Group*").

In *Covad Communications Co. v. BellSouth Corp.*, 374 F.3d 1044 (11th Cir. 2004) ("*BellSouth*"), the court, addressing price squeeze allegations "substantially similar" to those here,[10] held the "[plaintiff's] price squeezing claim survives because it is based on traditional antitrust doctrine and is not specifically barred by *Trinko*," and indeed *Trinko* "'preserves claims that satisfy existing antitrust standards.'" *Id.* at 1050, 1052 (quoting *Trinko*, 540 U.S. at 407).

In *Covad Communications Co. v. Bell Atlantic Corp.*, 398 F.3d 666 (D.C. Cir. 2005) ("*Bell Atlantic*"), the court held that the price squeeze claim there – alleging too high wholesale prices for the provisioning of unbundled loops compelled by new duties imposed under the Telecommunications Act of 1996 – was barred by *Trinko*. *Id.* at 673-74. Yet, as the D.C. Circuit explained in its order on denial of rehearing on that decision, the argument that "the court's holding 'eliminates' the antitrust claim of a price squeeze, simply misreads our opinion." *Covad Communications Co. v. Bell Atlantic Corp.*, 407 F.3d 1220, 1222 (D.C. Cir. 2005). "Notably, the court did not face a circumstance similar to that in *Covad Communications Co. v. BellSouth Corp.*, 374 F.3d 1044, 1050-52 (2004), in which the Eleventh Circuit held a claim for predatory pricing of loops could proceed; in that case the complaint alleged the 'basic prerequisites for . . . price predation.'" *Id.*

Judge Gould's dissent also confirmed that while "*Trinko* insulates from antitrust review the setting of the upstream [wholesale] price" (Pet. App. 22a), "if

10. Pet. App. 49a n.16 (2005 Order).

[respondents] are able to allege that the [petitioners] had market power in the retail market to set or influence the price, and that their retail sales of internet connection were predatory in the sense of being below cost with a real prospect of recoupment, then the case should proceed for factual development" (*id.* at 20a-21a).

B. Recognizing the viability of a predatory retail pricing claim (as set out in Judge Gould's dissent) would not chill competitive pricing, harm consumers, or conflict with any regulatory regime designed to address the antitrust harm of the challenged pricing conduct. Such a claim is directed at unregulated, exclusionary pricing "to eliminate or retard competition and thereby gain and exercise control over prices in the relevant market" (*Brooke Group*, 509 U.S. at 222), depriving consumers of lower prices, better (more diverse) products, and more efficient production methods.

Imposing antitrust liability for such predatory retail pricing would not undermine or override any regulatory regime or structure designed to deter or remedy the anticompetitive harm of that pricing conduct. *Trinko*, 540 U.S. at 411-12 (citing *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990) (Breyer, C.J.)). Here – unlike *Trinko* and *Town of Concord* – the challenged conduct does not arise in the context of a fully regulated industry. Specifically, in the retail DSL market, there has been "no comparable regulatory attention" as on the wholesale side and hence "[a]ny restrictions on pricing at the retail level derive primarily from the antitrust laws." Pet. App. 18a (panel majority opinion). The challenged retail pricing conduct would

implicate the "special problem" that "is posed by a monopolist, regulated at only one level, who seeks to dominate a second, unregulated level, in order to earn at that second level the very profits that regulation forbids at the first." *Town of Concord*, 915 F.2d at 29 (citing 3 P. Areeda & D. Turner, *Antitrust Law* ¶ 726e, at 217-20 (1978)).

II. Respondents' price squeeze allegations in its amended complaint are, as the district court's 2005 Order noted, "substantially similar" to those that the Eleventh Circuit's *BellSouth* decision found sufficient at the pleading stage to satisfy *Brooke Group* and that were distinguished by, and would survive under, the D.C. Circuit's *Bell Atlantic* decision.[11] Petitioners and the Government correctly note, however, that the district court's 2005 Order ruling that the amended complaint pled a *Brooke Group* predatory pricing claim was decided under the "no set of facts" pleading standard (*Conley*, 355 U.S. at 45-46) that was subsequently repudiated in *Twombly*, 127 S. Ct. at 1969. And they agree with Judge Gould's dissent that the amended complaint does not state a *Brooke Group* claim.

But whether respondents do or can sufficiently plead a predatory pricing claim under *Brooke Group*, particularly in light of *Twombly*, need not and should

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11. As the district court below ruled in denying petitioners' motion to dismiss, "even if the *Brooke Group* requirements were applied, the [amended complaint] would satisfy those requirements," noting it "contains price squeeze allegations substantially similar to those approved by the [Eleventh Circuit] in [*BellSouth*]." Pet. App. 48a-49a & n.16.

not be decided on this interlocutory appeal – and neither petitioners nor the Government suggest it should.[12] As Judge Gould recommended, the proper course is to remand this case back to the district court with instructions that respondents be given leave to amend their complaint to allege, if they can, a valid retail predatory pricing claim under *Brooke Group*.

ARGUMENT

I. *TRINKO* DOES NOT BAR A PREDATORY PRICING CLAIM THAT SATISFIES THE ELEMENTS OF *BROOKE GROUP*

A. A Predatory Pricing Claim Is Viable Under Established Antitrust Standards

As the panel majority decision observed, "*Trinko* took great care to explain that in this particular regulatory context, 'claims that satisfy established antitrust standards' are preserved." Pet. App. 14a

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12. As the Government has stated, "it is unclear whether the 2005 Order and the amended complaint are properly at issue in this interlocutory appeal." U.S. Merits Brief at 17. At the petition stage, the Government stated:

> To be sure, the Court might lack jurisdiction to decide the distinct questions whether (a) respondents could avoid dismissal by alleging the elements of a predatory-pricing claim under *Brooke Group*, and (b) whether the amended complaint alleged such a claim, but those questions would not merit this Court's review at this time in any event.

U.S. Invitation Brief at 20 n.8.

(quoting *Trinko*, 540 U.S. at 406). *Trinko* addressed whether the conduct complained of there, involving a defendant's "alleged insufficient assistance in the provision of service to rivals," violated "pre-existing antitrust standards," and concluded it was not "a recognized antitrust claim under this Court's existing refusal-to-deal precedents." *Trinko*, 540 U.S. at 407, 410. Here, as the Eleventh and D.C. Circuits and Judge Gould's dissent have confirmed, predatory pricing claims that satisfy *Brooke Group* satisfy "'established antitrust standards'" and hence are not barred by *Trinko*.

The Government states that here "[a]llegations satisfying the *Brooke Group* requirements with respect to the retail market might suffice," and that such a claim, "to be viable, it would have to satisfy *Brooke Group* by alleging that 'the prices complained of are below an appropriate measure of its rival's costs' and that the defendant had 'a dangerous probability[] of recouping its investment in below-cost prices.'" U.S. Merits Brief at 29 (quoting *Brooke Group*, 509 U.S. at 222, 224; citing Pet. App. 20a-21a (Gould, J., dissenting))[13]; *see also id.* at 9 ("[t]o state a claim based on petitioners' retail prices, respondents would have to allege the two requirements established by this Court for predatory-pricing" under *Brooke Group*).

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13. As the Government notes: "[T]wo other circuits have correctly recognized that *Trinko* and *Brooke Group* combine to bar a margin-based price-squeeze claim. See *Covad Commc'ns Co. v. BellSouth Corp.*, 374 F.3d 1044 (11th Cir. 2004), cert. denied, 544 U.S. 904 (2005); *Covad Commc'ns Co. v. Bell Atl. Corp.*, 398 F.3d 666, 673-674 (D.C. Cir.), order on denial of reh'g, 407 F.3d 1220, 1222 (D.C. Cir. 2005); see also U.S. Invitation Br. 15-16." U.S. Merits Brief at 29 n.18.

Petitioners too have agreed that

> [a]n integrated retail provider could 'squeeze' rivals by lowering its prices below its costs, but, where that is an antitrust wrong, the rules of predatory pricing – which require a plaintiff to show both below-cost pricing and a likelihood of recoupment of losses, *see Brooke Group*, 509 U.S. at 222, 224 – fully address that behavior. *See* 3A [Phillip E.] Areeda & [Herbert] Hovenkamp ¶ 767c, at 127 [(2d ed. 2002)] (only potential competitive harm from 'price squeeze' should be 'resolved under the law of predatory pricing').

Pet. 21-22; *see also id.* at 3 ("low prices are not unlawful unless predatory pursuant to the standard established in *Brooke Group*"), at 26 ("this Court has adopted for predatory-pricing claims a rule that is clear and administrable").

Neither petitioners nor the Government appear to dispute that a *Brooke Group* claim involving predatory pricing in the retail market would state a viable claim not barred by *Trinko*, so that, as Judge Gould concluded,

> if plaintiffs are able to allege that the [petitioners] had market power in the retail market to set or influence the price, and that their retail sales of internet connection were predatory in the sense of being below cost with a real prospect of recoupment, then the case should proceed for factual development.

Pet. App. 20a-21a.

At the petition stage, the Government questioned whether the Court has jurisdiction to decide the question "whether . . . respondents could avoid dismissal by alleging the elements of a predatory-pricing claim under *Brooke Group.*" U.S. Invitation Brief at 20 n.8. But there can be no proper basis for contesting Judge Gould's conclusion that a predatory retail pricing claim satisfying the elements of *Brooke Group* would survive *Trinko;* indeed that conclusion accords with the two circuit court decisions having addressed the question of whether a *Brooke Group* predatory pricing-squeeze claim survives *Trinko.*

B. The Decisions of the Eleventh and D.C. Circuits and Judge Gould's Dissent Confirm *Trinko* Does Not Bar a *Brooke Group* Claim

1. The Eleventh Circuit's decision in *BellSouth* held that the "[plaintiff's] price squeezing claim survives because it is based on traditional antitrust doctrine and is not specifically barred by *Trinko*." 374 F.3d at 1050. *BellSouth* noted that *Trinko* "'preserves claims that satisfy existing antitrust standards'" in rejecting the argument that *Trinko* or the federal telecommunications regulation excluded facially valid predatory price squeeze claims. *Id.* at 1052 (quoting *Trinko*, 540 U.S. at 407). It stated "[o]ur responsibility under *Trinko* to harmonize the Sherman Act and the [Federal Telecommunications Act] does not entail excluding facially valid antitrust claims at the pleadings stage." *Id.*

The Eleventh Circuit determined in *BellSouth* that the plaintiffs' price-squeezing claim must and did "contain allegations that the two basic prerequisites for a showing of price predation under § 2 of the Sherman Act have been met" – that is, (a) "'the prices complained of are below an appropriate measure of its rival's costs'" and (b) "'a dangerous probability[] of recouping its investment in below-cost prices.'" *Id.* at 1050 (quoting *Brooke Group*, 509 U.S. at 222, 224). In determining the plaintiffs there had sufficiently pled those elements, the court relied upon allegations "substantially similar" to those in respondents' amended complaint, as noted in the district court's 2005 Order. Pet. App. 48a-49a & n.16; *id.* Pet. App. 52a.

2. The D.C. Circuit's opinion in *Bell Atlantic* also recognizes that a predatory pricing claim survives *Trinko.* The court's initial opinion held that the price squeeze claim alleging an ILEC's [incumbent local exchange carrier] too high wholesale prices for the provisioning of unbundled loops – a provisioning that was purely the product of "statutory compulsion" – was indistinguishable from and barred by *Trinko*. 398 F.3d at 673. The court then added, "[a]nd, as observed in a leading treatise, 'it makes no sense to prohibit a predatory price squeeze in circumstances where the integrated monopolist is free to refuse to deal.'" *Id. (*quoting 3A Areeda & Hovenkamp, *Antitrust Law* ¶ 767c3, at 129-30 (2d ed. 2002)). Petitioners assert that "[t]his Court should endorse that view." Petitioners' Brief at 35. That view and the quoted passage from the "leading treatise" cannot be read to reject predatory pricing claims absent an antitrust duty to deal.

First, as the D.C. Circuit explained in its order on denial of rehearing on that decision, the suggestion that "the court's holding 'eliminates' the antitrust claim of a price squeeze, simply misreads our opinion." *Bell Atlantic*, 407 F.3d at 1222. "Notably, the court did not face a circumstance similar to that in *Covad Communications Co. v. BellSouth Corp.*, 374 F.3d 1044, 1050-52 (2004), in which the Eleventh Circuit held a claim for predatory pricing of loops could proceed; in that case the complaint alleged the 'basic prerequisites for . . . price predation.'" *Id.* "Here, Covad did not argue its claim as one of price predation and, unsurprisingly, we did not treat it as such." *Id.*

Second, as Judge Gould's dissent points out, while *Bell Atlantic* views *Trinko* as "insulat[ing] from antitrust review the setting of the upstream [wholesale] price" that "does not dispose of scrutiny of [petitioner's] conduct in the retail market, for it is the price at which [petitioner] sells DSL service to its retail customers that squeezes [respondents]." Pet. App. 22a. Thus, a properly pled *Brooke Group* claim alleging predatory pricing in that retail market would not be barred by *Trinko*. *Id.* at 20a-21a.

Third, the quoted passage from "the leading treatise" is premised on the assumption that the integrated monopolist "was free to refuse to deal," so the predatory price squeeze conduct could not have harmed competition or consumers any more than a lawful outright refusal to deal. Here, however, the monopolist had a legal duty to deal, albeit based on regulation, and hence could not lawfully refuse to deal with its competitors in the downstream market.

Therefore, predatory pricing accomplishing elimination of competition and monopolization in the downstream market would harm consumer welfare – in the form of higher prices, reduced choice and loss of efficiency and superior services (as alleged here, J.A. 37-38 (¶ 26)) – in a manner that could not have been accomplished by a lawful refusal to deal. *See Town of Concord*, 915 F.2d at 29 (recognizing the "special problem" posed by a price squeezing "monopolist, regulated at only one level, who seeks to dominate a second, unregulated level"); *id.* at 21-22 ("[A] practice is 'anticompetitive' only if it harms the competitive process. It harms that process when it obstructs the achievement of competition's basic goals – lower prices, better products, and more efficient production methods." (citations omitted)). Indeed, the treatise recognizes that "a predatory price squeeze by an integrated monopolist should be unlawful . . . where monopolization of the second stage would be unlawful." 3A Areeda & Hovenkamp, *Antitrust Law* ¶ 767c5, at 130. It also confirms a predatory pricing squeeze can harm competition and therefore "raises a question of unlawful conduct, but that question must be resolved under the law of predatory pricing." *Id.* ¶ 767c, at 127; Pet. at 21-22.

Finally, nothing in *Trinko* or *Brooke Group* suggests that such a predatory pricing claim is barred unless the monopolist had an antitrust duty to deal with the predatory pricing victim.[14] Reading *Trinko* in such a

14. *See Trinko*, 540 U.S. at 410 ("We conclude that Verizon's alleged insufficient assistance in the provision of service to rivals is not a recognized antitrust claim under this Court's (Cont'd)

manner would confer antitrust immunity for predatory pricing schemes harming consumer welfare where the duty to deal giving rise to competition stems from regulation rather than antitrust. Petitioners, however, have never suggested the regulation giving rise to the duty to deal here, any more than the regulation addressed in *Trinko*, conferred antitrust immunity. Reading *Trinko* to bar predatory pricing claims would put it at odds with *Brooke Group*. And it would allow monopolists to use their regulatory duties to deal in the upstream (wholesale) market to immunize unregulated predatory pricing to eliminate competition in the downstream (retail) market and thereby monopolize that market to the detriment of consumer welfare. As Justice (then Chief Judge) Breyer stated in *Town of Concord*: "We recognize that a special problem is posed by a [price squeezing] monopolist, regulated at only one level, who seeks to dominate a second, unregulated level, in order to earn at that second level the very profits that regulation forbids at the first." 915 F.2d at 29.

Therefore, as Judge Gould's dissent recognized, in line with *BellSouth* and *Bell Atlantic*, a complaint containing allegations sufficient to satisfy the *Brooke Group* requirements with respect to the retail market would be viable and not barred by *Trinko*. Pet. App. 22a-24a.

(Cont'd)

existing refusal-to-deal precedents."); *Brooke Group*, 509 U.S. at 222-26; *id.* at 222 ("the essence of the claim . . . is . . . [a] business rival has priced its products in an unfair manner with an object to eliminate or retard competition and thereby gain and exercise control over prices in the relevant market").

C. Recognition of a *Brooke Group* Claim Along the Lines Suggested by Judge Gould's Dissent Would Not Threaten to Undermine *Trinko* or Fundamental Antitrust Principles

Petitioners and its *amici curiae* argue that recognition of a "price-margin" claim of the type alleged in the initial complaint would undermine *Trinko* and well-settled antitrust doctrine. These arguments are clearly inapplicable to a predatory retail pricing claim satisfying the requirements of *Brooke Group* as discussed in Judge Gould's dissent.[15]

1. Predatory pricing claims that satisfy the requirements of *Brooke Group* are different from those addressed in *Trinko* and "'satisfy established antitrust standards'" and so are preserved under the reasoning of *Trinko.* Recognizing such claims would not impinge on any legitimate element of a "free-market system" or chill legitimate economic growth or innovation, as discussed in *Trinko;* nor would it force an upstream monopolist to uneconomically prop up less efficient downstream rivals to the detriment of consumer welfare. Rather, a *Brooke Group* predatory retail pricing claim of the type discussed in Judge Gould's dissent is directed

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15. It is unclear that these arguments, rebutted here, were directed at a predatory retail pricing claim along the lines Judge Gould set forth; they seem to be directed at "price-margin squeeze" claims only. But petitioners recommend "endors[ing]" the view that "'it makes no sense to prohibit a predatory price squeeze in circumstances where the integrated monopolist is free to refuse to deal'" (setting aside that petitioners here were not "free to refuse to deal"). *Bell Atlantic*, 398 F.3d at 673 (citation omitted). So, caution dictates addressing them in this brief.

at an upstream monopolist's unregulated conduct to eliminate equally efficient competition in a downstream retail market. S*ee Town of Concord*, 915 F.2d at 29 (recognizing the "special problem . . . posed by a monopolist, regulated at only one level, who seeks to dominate a second, unregulated level"). Such a claim does not chill lawful price cutting or put upward pressure on prices to the detriment of consumers. Rather, it preserves retail competition from equally efficient competitors, and thereby achieves "competition's basic goals" of "lower prices, better products, and more efficient production methods." *Id.* at 22; *see also Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) ("Congress designed the Sherman Act as a 'consumer welfare prescription'" (citation omitted)).

Indeed, the "essence" of a predatory pricing claim is that a "business rival has priced its products in an unfair manner with an object to eliminate or retard competition and thereby gain and exercise control over prices in the relevant market." *Brooke Group*, 509 U.S. at 222. As stated in *Town of Concord*, as an argument "against permitting extension of monopoly power": "The existence of competitors at a second 'level,' irrespective of their effects upon price, provides an added incentive for the monopolist to develop better products and better, more efficient ways to produce the product." 915 F.2d at 24; *see also* U.S. Department of Justice, *Competition and Monopoly: Single-Firm Conduct Under Section 2 of the Sherman Act* 56-57 (2008) ("Indeed, the consensus at the hearings, and the predominant (but by no means unanimous) view among commentators, is that, in certain circumstances, predatory pricing can be a rational strategy for a firm with monopoly power facing a smaller competitor.").

2. Petitioners have suggested that *Trinko* mandates dismissal of a price-margin squeeze claim based on their assertion that any conceivable threat to competition posed by such a squeeze could be remedied by regulatory oversight. Petitioners' Brief at 35-37. They have relied on a section in *Trinko* discussing regulatory oversight that has no application to claims, such as a *Brooke Group* predatory pricing claim, that already fall within "'established antitrust standards.'" *Id.* at 406, 410-12. *Trinko*, having determined that the plaintiffs' "insufficient assistance" claims would not make a "recognized antitrust claim under this Court's existing refusal-to-deal precedents," looked to whether "traditional antitrust principles justify adding the present case to the few existing exceptions from the proposition that there is no duty to aid competitors." 540 U.S. at 410-11. In doing so, it stated that "[o]ne factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm." *Id.* at 412. Hence, the Court did not say that the existence of a regulatory scheme would serve to bar judicial enforcement of the antitrust laws, surely not for predatory pricing claims satisfying "'established antitrust standards.'" *Id.* at 406.

Further, with reference to the "implied immunity" doctrine discussed in *Trinko*, it is recognized that "[a]n implied immunity may be found only where there is 'a convincing showing of clear repugnancy between the antitrust laws and the regulatory system.'" *Phonetele, Inc. v. American Telephone & Telegraph Co.*, 664 F.2d 716, 726 (9th Cir. 1981) (Kennedy, J.) (citation omitted). And even then, an exemption will be implied "'only to the minimum extent necessary'" in order "'to make the

regulatory Act work.'" *Id.* at 730 n.37 (citation omitted). Further, "the mere existence of a [regulatory] remedy within the Act does not indicate a congressional intent to displace the antitrust laws." *Id.* at 735. This is true even though the remedial scheme under the Act involved "different substantive standards." *Id.* at 734 n.46. It is well established that the "freedom of a party injured by anticompetitive conduct to elect between an administrative [Federal Communications Act] remedy and a judicial cause of action under the Clayton Act is quite acceptable; the latter need not derogate or interfere with the former." *Id.*

Moreover, as the panel majority below recognized "the existence of regulation does not always eliminate the danger of anticompetitive harm." Pet. App. 15a. "The key, under *Trinko*, is the nature of the regulatory structure at issue." *Id.*; *see Trinko*, 540 U.S. at 412. Significantly, here, unlike *Trinko* and *Town of Concord*, the challenged conduct does not arise in the context of a fully regulated industry. Rather, as the Ninth Circuit panel majority recognized, there has been "no comparable regulatory attention paid to the retail DSL market" and hence any "restrictions on pricing at the retail level derive primarily from the antitrust laws." Pet. App. 18a; *see also Town of Concord*, 915 F.2d at 29 (recognizing the "special problem" posed by a price squeezing "monopolist, regulated at only one level, who seeks to dominate a second, unregulated level").

Petitioners refer to the FCC's decision not to subject Internet service to the "common-carrier regulation" duties imposed on ILECs for their provision of transmission facilities used to provide DSL service.

See National Cable & Telecommunications Ass'n v. Brand X Internet Services, 545 U.S. 967, 976, 993-94, 1001 (2005). Yet nothing in that determination suggests, much less establishes, that a "regulatory structure" exists "to deter and remedy anticompetitive harm" (*Trinko*, 540 U.S. at 412) of predatory retail pricing. Nor does it discredit the Ninth Circuit's panel majority view, apparently shared by Judge Gould (Pet. App. 22a), that restrictions on pricing at the retail DSL level derive primarily from the antitrust laws (*id.* at 18a). Nor does it demonstrate any tension, much less clear repugnancy, between the regulatory regime and the antitrust laws.

3. Recognition of a predatory pricing claim would not impermissibly impose administratively unwieldy "day-to-day" supervisory duties on antitrust courts, as was the case in *Trinko* with respect to alleged anticompetitive violations of the regulatory sharing requirements of the Telecommunications Act of 1996. *Trinko*, 540 U.S. at 415. Unlike "[e]ffective remediation of violations of regulatory sharing requirements [that] will ordinarily require continuing supervision of a highly detailed decree," redressing predatory retail pricing does not involve such "continuing supervision," any more than would be entailed in addressing any other below-cost predatory pricing schemes. *Id.* at 414-15. Courts have provided necessary and effective stewardship of the antitrust function in addressing predatory pricing.

Indeed, courts are needed and suited to redress such predatory retail pricing where as here "restrictions on pricing at the retail level derive primarily from the antitrust laws." Pet. App. 18a (panel majority decision).

That is particularly true in cases where the unregulated retail prices are set below the monopolists' own costs for providing service in order to exclude, or dominate, retail competition – and thereby raise prices and harm consumers. *See Town of Concord*, 915 F.2d at 28-29. In such cases, a court's "practicable ability" in assessing predatory pricing claims is no more difficult, and imposes no more "continuing supervision," than applying pricing and costs standards for any other predatory pricing claims under *Brooke Group*.

4. In the First Circuit's decision in *Town of Concord*, Justice (then Chief Judge) Breyer stated a pricing squeeze "does not ordinarily violate Sherman Act § 2 where the defendant's prices are regulated at both the primary and secondary levels." 915 F.2d at 22. As that court then clarified: "In so holding, we *are not* saying either that the antitrust laws do not apply in this regulatory context, or that they somehow apply less stringently here than elsewhere." *Id.* (emphasis in original). "And we have stressed that our reasoning applies with full force only when the monopolist who engages in the squeeze is regulated at both industry levels." *Id.* at 29.

The *Town of Concord* court further stated: "We recognize that a special problem is posed by a [price-squeezing] monopolist, regulated at only one level, who seeks to dominate a second, unregulated level, in order to earn at that second level the very profits that regulation forbids at the first." *Id.* Such a "special problem" of anticompetitive harm as identified in *Town of Concord* would warrant antitrust court enforcement where regulated upstream monopolists engage in

predatory pricing conduct eliminating competition in an unregulated retail market, depriving consumers of lower prices, a choice of service providers, greater efficiency and enhanced products, as alleged here. J.A. 19-20 (¶ 24).

5. In sum, recognition of the validity of a predatory pricing claim would not promote competitors at the expense of lawful price competition, economic efficiency, or consumer welfare. Rather it is grounded in sound and settled antitrust principles directed at redressing predatory pricing conduct enabling the possession and exercise of monopoly power to the detriment of competition-consumer welfare that the antitrust laws were enacted to protect.

II. WHETHER RESPONDENTS HAVE STATED A VALID *BROOKE GROUP* CLAIM THAT WOULD SURVIVE UNDER THE *TWOMBLY* STANDARD, OR CAN STATE SUCH A CLAIM, NEED NOT AND SHOULD NOT BE DECIDED

Petitioners and the Government do not seem to dispute that the claims in respondents' amended complaint are "substantially similar" to those that survived *Brooke Group-Trinko* pleading attack in the Eleventh Circuit's *BellSouth* decision, as noted in the district court's 2005 Order ruling that "even if the *Brooke Group* requirements were applied, the [amended complaint] would satisfy those requirements." Pet. App. 48a-49a & n.16. Petitioners and the Government disagree with that ruling, while questioning whether the amended complaint and 2005 Order are even properly at issue here (*see* U.S. Merits Brief at 17;

Petitioners' Brief at 9 n.6). They correctly point out that this ruling, like the holding in *BellSouth*, was decided under the "no set of facts" standard (*Conley*, 355 U.S. at 45-46) subsequently repudiated by *Twombly*, 127 S. Ct. at 1969. But whether respondents do or can state a retail predatory pricing claim that would survive a pleading attack under the *Twombly* standard was not raised or decided below, and is best handled on remand, allowing respondents an opportunity to amend the complaint (as Judge Gould's dissent recommends) and having any amended pleadings then addressed under the *Twombly* standard.

A. Respondents' Price Squeeze Allegations of the Amended Complaint Were Substantially Similar to Those That *BellSouth* Held Stated *Brooke Group* Elements of Predatory Pricing

Respondents' price squeeze allegations in their amended complaint, which the district court ruled (in its 2005 Order) satisfied *Brooke Group* requirements, would have survived under the Eleventh Circuit's decision in *BellSouth* and the D.C. Circuit's own interpretation of its opinion in *Bell Atlantic*, reconciling that decision with the Eleventh Circuit's *BellSouth* decision allowing price squeeze claims to proceed on the basis of allegations like those here.

In addressing the sufficiency of the pleadings on the below-cost pricing requirement of *Brooke Group*, the court in *BellSouth* focused on allegations, like those of the amended complaint here, that retail prices for combined DSL and Internet access service were set below the prices charged at wholesale for the DSL

component alone. 374 F.3d at 1051. The court stated, "[i]f it is true that . . . the retail prices it is charging individual customers for combined DSL and Internet service, are 'below an appropriate measure of [BellSouth's] costs,' that fact suffices to satisfy the first prong of a price predation offense under § 2 of the Sherman Act." *Id.* at 1051-52 (citation omitted; brackets in original). The court added, "whether the unbundled wholesale loop prices BellSouth charges Covad pursuant to the interconnection agreement are the 'appropriate measure of [BellSouth's] costs' is a matter for the trier of fact to determine." *Id.* at 1052 (citation omitted; brackets in original); *see Brooke Group*, 509 U.S. at 222 n.1 ("Because the parties in this case agree that the relevant measure of cost is average variable cost, however, we again decline to resolve the conflict among the lower courts over the appropriate measure of cost.").

The *BellSouth* court noted that, as is true for the wholesale DSL transport prices here, the wholesale loop prices were determined, under the relevant regulation (there the 1996 Federal Telecommunications Act "FTCA"), using the "same baseline standard – namely, 'cost' – . . . as does the *Brooke Group* antitrust test of price predation." 374 F.3d at 1052. The court did not regard Covad's use of a regulation-based "at-cost measure" as contrary to "*Trinko*'s discussion of the FTCA's regulatory priority over antitrust law enforcement." *Id.* at 1051. The court stated "[t]o say that Covad's price squeezing claim defines the 'appropriate measure of [BellSouth's] costs,' in terms of an obligation created by the FTCA is to say very little when the FTCA itself relies upon 'cost' as the appropriate measure by which to determine

interconnection and network element rates." *Id.* at 1052 (citation omitted). Therefore, the court "conclude[d] that Covad's price squeezing claim is based on traditional antitrust standards." *Id.* It added, "[o]ur responsibility under *Trinko* to harmonize the Sherman Act and the FTCA does not entail excluding facially valid antitrust claims at the pleadings stage." *Id.*

Here, similarly, respondents' amended complaint's price squeeze claim alleges that petitioners' retail prices for their bundled service of DSL access, Internet service and equipment (modem and installation) were set below prices charged to their retail affiliate and respondents for the DSL access component. J.A. 36 (¶ 25(A)(3)). Hence, there is a plausible basis to suggest petitioners could not have been covering their costs for their bundled service when offered at a price below the cost incurred by the retail affiliate for the DSL component. As in *BellSouth*, the district court regarded such pleading sufficient to satisfy the "below-cost pricing" requirement of *Brooke Group.* Pet. App. 50a-51a.[16]

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16. Petitioners criticize using its DSL transport price, saying they are free to charge rivals a high "monopoly" price for the wholesale input and ignore that price in setting retail prices. Petitioners' Brief at 32-33 nn. 20-21. That criticism, however, does not render the DSL transport price (incurred by its own retail affiliate) as an irrelevant frame of reference for assessing "an appropriate measure of cost," at least at the pleading stage, where, as in *BellSouth*, it was a cost-based price. And here the retail service bundled the DSL transport component along with other services and equipment (for which costs were also incurred) at prices below that cost-based price for the DSL transport component. Petitioners suggest they may

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On the element of recoupment, the *BellSouth* court relied upon allegations that BellSouth was artificially allocating costs such that it was "compensating for deliberately reduced profits on the retail end of its operations with correspondingly greater profits on the wholesale side, in order to stifle competition from firms such as Covad that are both wholesale customers and retail rivals." 374 F.3d at 1051.[17]

The district court here looked at substantially identical allegations in respondents' amended complaint (*see* Pet. App. 49a; J.A. 36 (¶ 25(A)(3)), but disagreed with the *BellSouth* ruling that such allegations would, standing alone, suffice to state recoupment under *Brooke Group* (Pet. App. 51a). The district court concluded,

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acquire additional sources of revenues to augment that retail price. But this injects factual issues as to whether the revenues from the bundled retail service cover the cost of providing it; it does not render the DSL transport cost-based price an irrelevant frame of reference, at the pleading stage.

17. The court referenced allegations that:

> 'If BellSouth had charged itself the same wholesale price for loops, BellSouth could not make a profit from its DSL service at current prices. . . . As the costs are presently allocated, BellSouth must necessarily realize a significantly higher profit margin on its wholesale sales (for which it faces no competition) than it does on the corresponding retail sales (for which Covad is attempting to compete). BellSouth intended this artificial cost allocation to harm Covad, and it did.'

BellSouth, 374 F.3d at 1051.

> [n]onetheless the [amended complaint] elsewhere alleges something akin to a dangerous probability of recoupment within the meaning of *Brooke Group* . . . [alleging] that, as a result of [petitioners'] anti-competitive conduct, 'competition in the provision of Internet services has been effectively eliminated in [petitioners'] California service areas, and consumers have been deprived of lower prices, a choice of service providers, greater efficiency and enhanced products.'

Pet. App. 51a-52a; J.A. 38 (¶ 26(b)). Further the amended complaint alleged that petitioners' retail affiliate had taken in excess of 80% of the relevant DSL market. J.A. 33 (¶ 20).

B. Challenges to the Sufficiency of Respondents' Predatory Price Squeeze Allegations Under *Twombly*, and Whether Respondents Can State a *Brooke Group* Predatory Retail Pricing Claim, Need Not and Should Not Be Addressed Here But Rather on Remand

The panel majority apparently did not believe these district court's *Brooke Group* rulings in its 2005 Order were before it or that it could or needed to address them.[18] And in the end, the appeals panel majority

18. Petitioners had argued to the court of appeals, "even if *Trinko* did not bar their price squeeze claim, the Court should not reach the *Brooke Group* issue because that issue is not properly before the Court." 05-56023, Docket No. 25, Appellant's Reply Brief at 18 (2/21/06).

decision affirmed the district court's denial of petitioners' "motion for judgment on the pleadings," which was the ruling in the 2004 Order addressing the initial complaint, not the 2005 Order on the amended complaint. Pet. App. 19a; *see also* U.S. Merits Brief at 8 n.5. The panel majority decision does not address the sufficiency of respondents' allegations under *Brooke Group*, or whether respondents' price squeeze claims would need to meet the pleading requirements for a predatory pricing claim under *Brooke Group.* Hence, as the Government has explained, "it is unclear whether the 2005 Order and the amended complaint are properly at issue in this interlocutory appeal." U.S. Invitation Brief at 20; U.S. Merits Brief at 17.

Judge Gould's dissent does not discuss the 2005 Order rulings on *Brooke Group.* In any event, Judge Gould concluded respondents could not state an antitrust violation for price squeeze without satisfying the predatory pricing requirements of *Brooke Group* with respect to petitioners' pricing in the retail DSL service market, finding the amended complaint allegations deficient in that regard. Pet. App. 22a-23a.[19]

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19. As set forth above, respondents' amended complaint's price squeeze claim alleged *Brooke Group* elements along the lines deemed sufficient in *BellSouth.* And, as the district court ruled, the amended complaint additionally alleged "something akin to a dangerous probability of recoupment" in that, as a result of petitioners' anticompetitive conduct, "'competition in the provision of Internet services has been effectively eliminated in [petitioners'] California service areas, and consumers have been deprived of lower prices, a choice of service providers, greater efficiency and enhanced products.'"

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But he "[did] not think it would be correct to dismiss the complaint on the pleadings with prejudice" because "we have not heretofore held that there must be a showing of market power in the retail market, nor held that the standards of *Brooke Group* must be applied in assessing predation in the retail side of a 'price squeeze.'" *Id.* at 23a. Instead, "after dismissal, [respondents] should have been free to amend their complaint if they could assert in good faith the allegations that are requisite here, after *Trinko*." *Id.* 23a-24a.

(Cont'd)

Pet. App. 51a-52a; J.A. 37-38 (¶ 26(b)). The amended complaint also alleged: (a) the market for DSL Internet service in petitioners' service region in California is a relevant market (J.A. 13 (¶ 11)); (b) petitioners have monopoly control over essential inputs to providing DSL service which cannot be practicably or reasonably duplicated (J.A. 28-29 (¶ 12), 31-32 (¶¶ 19-20)); and (c) petitioners' retail affiliate has in excess of 80% of the relevant DSL market (J.A. 33 (¶ 20)). Respondents believe the allegations of their amended complaint, albeit framed as a "price squeeze" claim, satisfy the elements of a retail predatory pricing-monopolization claim. But, in any event, as Judge Gould's dissent recommends, respondents should be allowed the opportunity to plead allegations of a pure (standalone) predatory retail pricing claim as outlined in his dissent. Pet. App. 22a ("'price squeeze' . . . boils down to a claim of a predatory pricing on sales of internet connections by [petitioners] in the retail market"); *id.* at 24a n.2 ("the district court . . . should have permitted amendment in case the critical allegations [of a *Brooke Group* predatory retail pricing claim] can be made by the [respondents]" as "[t]here is just enough possibility of an injury occurring for reasons culpable under the antitrust laws, *see Brunswick Corp. v. Pueblo Bowl-O-Mat*, 429 U.S. 477 (1977)").

Agreeing with Judge Gould, petitioners and the Government argue that the amended complaint price squeeze allegations are insufficient to satisfy *Brooke Group* and the district court's ruling to the contrary was decided under the "no set of facts" pleading standard repudiated in *Twombly.* Nonetheless, under Judge Gould's recommended disposition, petitioners, on remand, will have the opportunity to challenge whether any amended complaint satisfies the requirements of a *Brooke Group* predatory pricing claim under the *Twombly* pleading standard. Respondents believe that is the proper course to proceed, particularly since it is "unclear whether the 2005 Order and the amended complaint are properly at issue in this interlocutory appeal" (U.S. Merits Brief at 17), and the *Twombly* issue was not raised or decided below.[20]

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20. As the Government has stated, "[t]o be sure, the Court might lack jurisdiction to decide the distinct question[] . . . whether the amended complaint alleged a [*Brooke Group* predatory pricing] claim, but [that] question[] would not merit this Court's review at this time in any event." U.S. Invitation Brief at 20 n.8.

CONCLUSION

The judgment should be, as suggested by Judge Gould's dissent, vacated and the case remanded for further proceedings in the district court consistent with the substantive law as set forth in Judge Gould's dissent.

Respectfully submitted,

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